In the Supreme Court of the United States

OCTOBER TERM, 1972

72-1491

DUDLEY T. DOUGHERTY, ET AL, CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL,
Petitioners

v.

TEXACO INC., CONSOLIDATED GAS SUPPLY CORPORATION, PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, WARREN PETROLEUM CORPORATION, TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO, INC., PHILLIPS PETROLEUM COMPANY

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

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I N D E X

CITATIONS

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VS.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

The Estate of Mrs. James R. Dougherty, et al, intervenors in the court of appeals in behalf of the Federal Power Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia entered on December 12, 1972, rehearing denied February 5, 1973. This petition is filed in conjunction with the petition filed in the cause by the Solicitor General on behalf of the Federal Power Commission.

OPINION BELOW

The opinion of the court of appeals (App. A, pp. 1a-22a)* is not yet reported. The initial order (No. 428) of the Federal Power Commission (App. D, pp. 29a-46a), its order (No. 428-A) of amendment (App. E, pp. 47a-49a), and its order No. 428-B) denying rehearing (App. F, pp. 50a-84a) are reported at 45 F.P.C. 454, 45 F.P.C. 458, and 46 F.P.C. 47 respectively.

JURISDICTION

The judgment of the court of appeals was entered on December 12, 1972 (App. B, pp. 23a-25a). Timely Petition for Rehearing was filed by the Commission and by Petitioner and was denied on February 5, 1973. (App. C, pp. 26a-28a). The jurisdiction of the Court is invoked under 28 U.S.C 1254(1).

STATUTES INVOLVED

Sections 4, 5, 7, and 16 of the Natural Gas Act, 15 U.S.C. 717(c), 717(d), 717(f), and 717(o), are set forth in App. G, pp. 85a-93a.

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* All references to appendices contained herein are references to the appendices appended to the petition filed by the Solicitor General.

QUESTIONS PRESENTED

Whether the Natural Gas Act, Section 4(a) of which provides that "[a]ll rates and charges...received by any natural-gas company...shall be just and reasonable..." prohibits the Federal Power Commission from adopting a method of indirect regulation of the wellhead gas rates charged by small producers based upon market factors.

STATEMENT

The United States Court of Appeals for the District of Columbia in the opinion below, set aside the orders of the Federal Power Commission in docket No. R-393, which are Orders 428, 428-A, and 428-B. These Orders were issued by the Federal Power Commission in a rulemaking proceeding instituted by Notice of Rulemaking issued by the Commission on July 23, 1970. 35 Fed. Reg. 12220. After an opportunity for interested parties to comment had been afforded, the Commission issued Order 428 on March 18, 1971. This order was modified on April 9, 1971 and Order 428-A substituted, and in response to a Petition for Rehearing by interested parties, the Order was again modified on July 15, 1971, in Order 428-B.

In order 428 the Commission promulgated a regulation that relieved producers of less than ten million mcf of gas per year from certain regulatory burdens. The action of the Federal Power Commission was challenged in the court of appeals by petitions filed pursuant to Section 19 of the Natural Gas Act, 15 U.S.C. 717(r)(b) by large producers, pipelines, a state commission, and one small producer. Petitioners intervened in support of the Commission in the court of appeals.

The Federal Power Commission indicated in promulgating Order 428 that the order was designed to help alleviate the growing national crisis resulting from a shortage of natural gas by stimulating the exploratory effort of the small producers, who drill approximately 80% of all the exploratory wells drilled in the United States. The Commission said that "One of the important Commission responsibilities under the Natural Gas Act is to assure maintenance of an adequate gas supply for the interstate market. By action herein, we are taking an important step to meet this responsibility." App. D, p. 31a. The Commission sought to fulfill this statutory responsibility by establishing a procedure under which small producers could obtain blanket certificates to cover all existing and future sales, by relieving the small producers of certain filing requirements and by relieving small producers of natural gas from the burden of direct price regulation.

Order 428 provided that small producers may collect from large producers and pipeline purchasers the price established by existing contracts between the producers and its purchasers, and, for gas that is sold on a contract negotiated in the future, the negotiated price. These prices were to be collected without regard to the applicable area rates and without refund obligations. The prices paid to small producers were, however, to be reviewed at the pipeline level. Generally, the purchaser would be permitted to pass on the increase subject to the following limitations: First, the flow-through must be allowed by the contract between the purchaser and the purchaser's purchaser. Second, the flow-through will be allowed only if the increase raises the purchaser's

average cost of natural gas more than one mill per mcf. Third, the purchaser must show that the price it is paying to the small producer is not unreasonably high. The criteria for determining whether or not the price is unreasonably high are the "highest contract prices for sales by large producers, or the prevailing market price for intrastate sales in the same producing area." Any increase that a purchaser passes through to its customers will be subject to refund in "either (1) a pipeline rate case, or (2) a proceeding involving only the tracking increase." (App. D, p. 37a).

The Commission continues to require its consent to the abandonment of the sale of jurisdictional gas as specified in Section 7b of the Act. 15 U.S.C. 717(f)(b). Therefore if a small producer is selling natural gas in the interstate market under Order 428 he must continue to sell it in that market at the contract price or area rate even after the original term of the contract has expired.

The Commission hoped to achieve its stated goal of increasing exploration without undue cost to the consumer. The Commission found that in 1969 small producers were selling only 10.52% of the interstate natural gas being sold. And since much of this gas was being sold under contracts negotiated many years ago, allowing the price for this gas to attain its contract price was unlikely to produce a significant price increase. There would be an increase in the cost of gas to consumers only if Order 428 was successful and new gas was found and dedicated to the interstate market. Even the price of such new gas will, however, be subject to viable market controls. The small producers are in a weak bargaining position as compared to the pipelines and

major producers who buy their gas; because of the limitation on the ability of the large producers and pipelines to pass through increases they are given extra incentive to bargain hard; and because of the relatively small market share that small producers have any increase in the price paid for their gas would have a relatively small impact on the price paid by the consumer.

The court of appeals held, one judge dissenting, that Order 428 went beyond the authority of the Commission because it did not insure that the rates at which small producers sold their natural gas would be "just and reasonable." 15 U.S.C. 717(c). Judge Fahy dissented on the grounds that the Commission had the authority to adopt market based regulation if rates producers will be "just and reasonable" and the Commission's assumption that such rates would be produced was not rebutted.

REASONS FOR GRANTING THE WRIT

The holding of the court of appeals is that the requirement of Sections 4 and 5 of the Natural Gas Act,15 U.S.C. 717(c) and 717(d), that all rates be "just and reasonable" precludes the Federal Power Commission from regulating the price of natural gas by means of market-based-indirect regulation. The court of appeals concluded that regulation by such market factors is the "antithesis of regulation" (App. A, p. 11a, n. 18), and that the essential difference between a regulated and unregulated industry is that "the latter is governed by the market while the former, by definition, is the subject of active governmental control." (App. A, p. 14a). This holding

drastically reduces the Commission ability to provide a regulatory system that achieves the goals of the Natural Gas Act to assure an adequate supply of natural gas at a "just and reasonable" rate.

1. There can no longer be a debate that the United States is now experiencing a natural gas shortage that is most serious nor that imaginative governmental action is necessary in order to prevent a crisis of the first order. See Placid Oil Co. v. FPC, ___ F.2d ___ (5th Cir. 1973) [Slip Op. pp. 23-30, April 16, 1973]; The Hugoton-Anadarko Area Rate Case, 466 F.2d 974 (9th Cir. 1972); City of Chicago v. FPC, 458 F.2d 731 (D.C. Cir. 1971). The central problem is that the United States is consuming natural gas at a rate far in excess of the rate at which natural gas is being found. See Placid Oil Co. v. FPC, supra, ___ F.2d at ___ [Slip Op. at 27]. It is obvious that in order to alievate this shortage it is necessary for the industry to find more natural gas. Since the small producer has traditionally drilled and apparently continues to drill the vast majority of the exploratory wells in the United States, the Commission reasonably concluded that if the exploratory activity of this part of the industry could be expanded there was a great likelihood that there would be an increase in the amount of new gas being found.

In order to stimulate the small producers' exploratory efforts it was necessary for the Commission to provide an incentive for them to explore and provide them with the financial resources necessary to carry on the exploration. It sought to accomplish these goals by providing a market environment in which the small producer would be

able to have the benefits of his success including the benefits of a low-cost operation and the benefits of a contract price which he negotiated in an environment in which he was free from direct constraints.

In the past, the Commission has sought to increase exploration incentives by adding a few cents to the price per mcf necessary to compensate the producer for his cost and to provide a reasonable rate of return. See Austral Oil Co. v. FPC, 428 F.2d 407, on rehearing, 444 F.2d 1257, cert. denied sub. nom, Municipal Distributors Group v. FPC, 400 U.S. 950 (1970); Placid Oil Co. v. FPC, supra. Although the amount of exploration, if any, that a particular number of cents per mcf will produce is inherently unknowable, such incentive factors have been found within the Commission's power to establish. See Austral Oil Co. v. FPC, supra; Placid Oil Co. v. FPC, supra. The basic difference between the incentive payments that have previously been approved and the scheme established in Order 428 was that Order 428 did not set any specific number of cents per mcf at which the natural gas was to be sold. No particular rate or charge was before the court of appeals for scrutiny as to its "justness" or "reasonableness." Instead, Order 428 set up a special kind of market that would provide both financial and psychological incentives to the producer to explore for natural gas and dedicate the natural gas found to the interstate market while at the same time providing protection for the consumers against exploitation by unreasonably high rates.

The court of appeals has read into the words "just and reasonable" a requirement that a specific price be always set by the

regulatory commission. There is no and never has been any such requirement. The terms "just and reasonable" "have no intrinsic meaning applicable alike to all situations." City of Chicago v. FPC, 458 F.2d 731, 750 (D.C. Cir. 1971). There is no holding that the term "just and reasonable" requires that specific price must be set and that market mechanisms can never be relied upon to produce such rates.

Indeed, this Court has made it clear that market factors may be an appropriate basis for determining rates. In Permian Basin Area Rate Cases, 390 U.S. 747 (1968), the Commission determined that rates geared to market prices would not at that particular time produce a "just and reasonable" rate. This Court affirmed that holding as being supported by the record, but refused to foreclose a different result in the future. Specifically this Court stated at 390 U.S. 799:

> "We do not now hold, and the Commission has not suggested, that field prices are without relevance to the Commission's calculation of just and reasonable rates.... The record in subsequent area rate proceedings may more clearly establish that the market mechanism will adequately protect the consumer interest. We hold only that, on this record, the Commission was not compelled to adopt field prices as the basis of its computation of area rates." (Emphasis supplied.)

The Commission, in Order 428, found that the market mechanism in a peculiar mar-

ket, specifically controlled by the Commission would adequately protect the consumer against unjust and unreasonable prices and provide incentive for the exploration for and dedication of new natural gas to the interstate market. The court of appeals, however, concluded that a market mechanism can never be an appropriate device for establishing "just and reasonable" rates. That conclusion is specifically and plainly inconsistent with the conclusion reached by this Court in the Permian Basin Area Rate Cases.

2. The effect of the court of appeals' holding is that the Federal Power Commission must establish some set rate per mcf for the sale of natural gas by all producers of natural gas. The process of such specific determination is inherently cumbersome and time consuming. See Placid Oil Co., supra, [Slip Op. at 2]. While the specific rate determination is proceeding, the exploration for natural gas by small producers will continue to drop and the percentage of natural gas that is found dedicated to interstate market will continue to fall. (Comments of George P. Morrill, R. 65-78). Moreover, as a result of the decision of the court of appeals all funds collected by the 4,600 small producers, pursuant to Order 428, are no longer available to finance exploration for natural gas and in order to insure that funds are available to pay refund claims, present exploration will be curtailed.

CONCLUSION

For the reasons stated herein and for the reasons stated in the petition filed by the Solicitor General, the petition for certiorari should be granted.

Respectfully submitted,

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